

**Support Senate Bill 298  
Montana Banker Association**

SENATE JUDICIARY

EXHIBIT NO. 2

DATE 3/3/09

BILL NO. SB 298

**Summary of the Hidden Lien Problem.** Consider this scenario:<sup>1</sup> A farmer takes out a \$1,000,000 loan with a bank financing his beet crop. In exchange for the loan, the farmer gives the bank a security interest in the beet crop. The bank properly files the UCC-1 financing statement and is in first-priority status. The farmer uses the loan funds for operating expenses, but due to changing circumstances decides to finance \$500,000 in agricultural chemical purchases directly through an agricultural supplier. The bank has no knowledge of the line of credit with the supplier until the agricultural supplier files agricultural liens in the fall after the bank's line of credit matures. The farmer fails to make his payments to the bank and the agricultural supplier when due and then sells his beet crop to the sugar company for \$500,000. Who gets the \$500,000? The agricultural supplier gets it. The agricultural lien has a superpriority over the bank's security interest, even though the bank's lien in the crops attached and perfected first and the bank receives no notification of the lien.

**Current Status of the Law.** Under §71-3-904, the fertilizer or pesticide lien has a *superpriority* over the bank's security interest created under the UCC. Normally, among competing UCC security interests, priority is generally determined by the chronological order of filing. Fertilizer and pesticide liens, however, will typically defeat all UCC security interests, even those filed earlier than the fertilizer or pesticide lien. This situation may encourage suppliers to sell unlimited amounts of inputs to marginal or distressed operators, all to the ultimate detriment of the bank.

**Remedy to the Problem – Balancing of Interests.** SB 298 does not attempt to completely resolve the hidden lien problem, but instead attempts to strike a reasonable and workable balance. The proposal still allows the holder of a fertilizer or pesticide lien to maintain superpriority lien status, but only up to \$25,000. Such a lien may exceed \$25,000, but excess amounts will be junior to prior UCC secured creditors such as banks. If a supplier is going to sell more than \$25,000 of supplies, this should encourage the supplier to engage in due diligence and collaboration prior to extending large lines of credit. Additionally, the \$25,000 threshold should be sufficient to *protect* Montana's crop dusters and applicators and other smaller suppliers.

**Why this Benefits the Farmer/Operator.** Under current law, these hidden liens can be devastating to agricultural lenders. More troubling is that even if the bank was able foresee the hidden lien, there is virtually nothing the bank can do to protect its collateral. This leads to riskier agricultural loan and in turn higher interest rates. However, if the agricultural lenders were able to accurately assess their potential risk (in this instance, a maximum of \$25,000) this problem is minimized.

**Working Together.** One critical item to understand is that the farmer's operating loan from the bank *includes funds for the purchase of all necessary fertilizer and pesticides*. By incorporating the proposed threshold, the supplier, farmer and bank will be encouraged to work in concert.

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<sup>1</sup> Based roughly on the facts of the recent case, *Stockman Bank of Montana v. Mon-Kota, Inc.*, 2008 MT 74 (March 4, 2008).

## SENATE BILL NO. 298

INTRODUCED BY J. LASLOVICH

A BILL FOR AN ACT ENTITLED: "AN ACT REVISING THE FERTILIZER AND PESTICIDE LIEN LAWS; ESTABLISHING AN EXCEPTION TO THE PRIORITY OF CERTAIN LIENS; AMENDING SECTION 71-3-904, MCA; AND PROVIDING AN IMMEDIATE EFFECTIVE DATE AND AN APPLICABILITY DATE."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MONTANA:

**Section 1.** Section 71-3-904, MCA, is amended to read:

**"71-3-904. Priority.** (1) The Except as provided in subsections (2) and (3), the lien for labor or services performed or material furnished as specified in this part shall be is prior to and have has precedence over any mortgage, encumbrance, or other lien upon said the grain or crops.,-except the

(2) A lien for seed, hail insurance, threshing, labor, and warehouse services furnished for the purpose of growing or handling the particular grain or crops is prior to and has precedence over a lien arising under this part.

(3) If a secured party is holding a perfected security interest obtained under Title 30, chapter 9A, in grain or crops whose security interest was perfected prior to the filing of a lien arising under this part, then a lien arising under this part:

(a) has priority and precedence up to an amount of \$25,000 over a perfected security interest obtained under Title 30, chapter 9A, in grain or crops; and

(b) any amount in excess of \$25,000 is considered junior and subordinate to the perfected security interest obtained under Title 30, chapter 9A, in grain or crops."

**NEW SECTION. Section 2. Effective date.** [This act] is effective on passage and approval.

**NEW SECTION. Section 3. Applicability.** [This act] applies to liens pursuant to 71-3-904 that are filed on or after [the effective date of this act].

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